DOW THEORY LETTERS INC.

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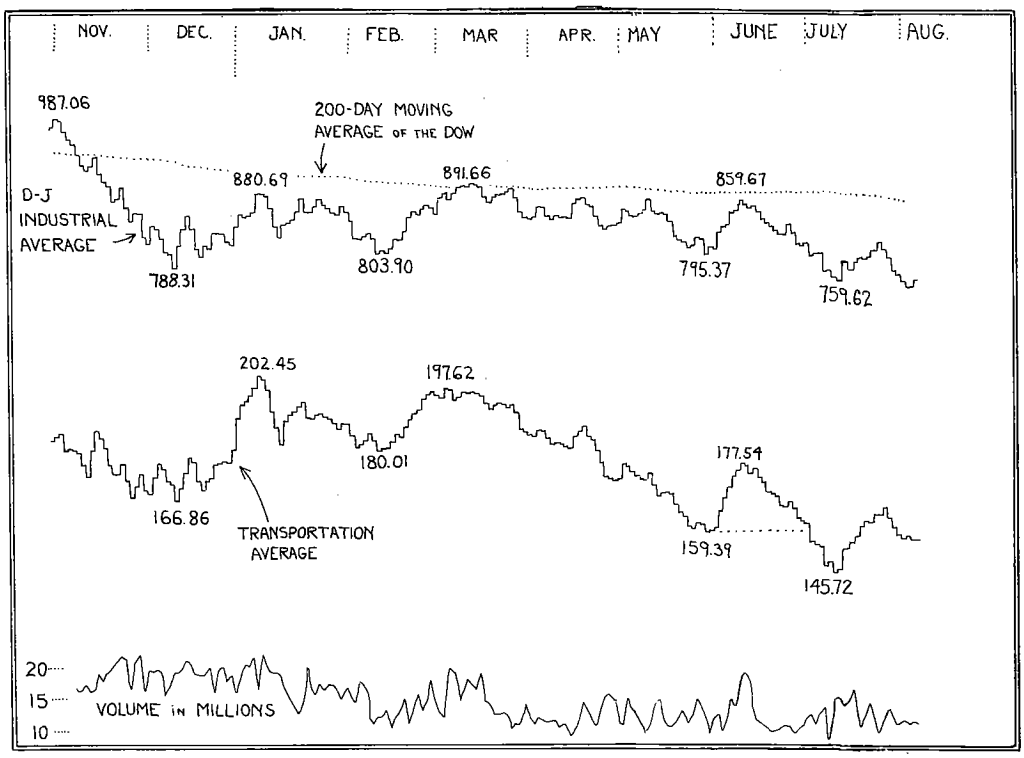
July 26, DJIA 784.57; PTI 362; A-D ratio -27.70
Aug. 2, DJIA 752.58; PTI 328; A-D ratio -29.12

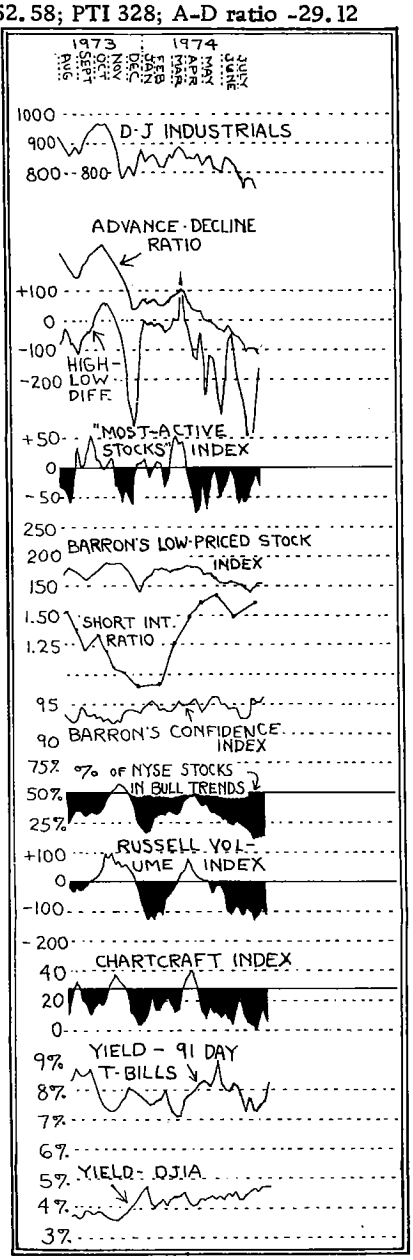
THE PICTURE: Many readers expressed shock at the long-term advance-decline study which was presented in Letter 603. Just in case these subscribers think that the A-D ratio offers a distorted picture of what is occurring, I will turn to the statistics released by the well known Trade Levels Report (Mutual Savings Building, 301 E. Colo. Blvd., Pasadena, CA 91101). They show that from the 1972 high to the July, 1974, low, the average NYSE issue (as per their unweighted average) has declined 57.2%. This actually surpassed the average decline during the 1969-70 smash. The 1969-70 decline worked out to an average drop of 56.5%.

The Trade Levels conclusion is as follows: "The overall decline in the market since the all-time high of December, 1968, is now 70.8%. It's hard to imagine that in just 5½ years the average stock has lost almost three quarters of its value!"

The overall market decline since 1966 (or 1968 if you wish) has been almost beyond the ken (certainly beyond the experience) of the great mass of brokers, advisors and portfolio managers. They have never seen anything like it. Yet, in my opinion, a subtle kind of optimism still pervades Wall Street. This optimism is based on a superficial acquaintance with the contrary opinion idea, and I call the new phenomenon "other-direct pessimism." Here's how it works: each advisory service tells you how pessimistic "everyone else is." The fact that everyone else is pessimistic, states these reports, has to have very bullish implications for the stock market, because when everyone else is bearish, it's bullish. To which I say "Bunk!"

Pessimism is when you are pessimistic along with the other guy. It's almost laughable to read all the still-hopeful advisors talking about "other people's" gloom. It reminds me of a fellow who was in here about a month ago telling me that he agreed with me, he was bearish on the stock market. "Is that right," I said, "Do you own any stocks?" Smiling he answered, "Oh not many. I sold well over half of my portfolio, and I'm only holding a few





blue chips like GM, Carbide, Goodyear and alot of Telephone." "You're still a bull," I told him, "you see, a bear doesn't own any stock (except golds). You're just less bullish than you were a little while ago." And that's how people kid themselves as they go broke during a bear market.

Actually, it is hard to fault Wall Street for its persistent hopefulness. Wall Street's very survival depends on selling securities, not gloom. In June it was reported that NYSE firms lost a combined $16.6 million, while member

 firms for the second quarter lost a whopping $96 million. Again I'll remind readers that Wall Street tends to lead the country, and the Street's current plight is telling those of us who care to listen a somber story. By this time next year I expect most of the nation (if not the world) to be sharing Wall Street's woes. Smashing the Wall Street barometer (as many would not like to do) will help no one; heeding the reading of the barometer might well save us.

I hardly get any satisfaction in saying it, but the many factors which I watch go together to make the "look" of a major bear market bottom simply do not exist today. In Letter 602 I included a chart of the British market and the Dow, commenting that we could (from the standpoint of history) expect the British market to bottom first. On July 30 the British market, still reeling in the grip of one of its worst collapses of the century, set another 15 year low. British real estate has recently dropped up to 40% in value, retail sales are at a two-year low, new car sales have fallen apart. And I am afraid that Britain is leading the way for the US and the world.

On other fronts, I will include a special study in the next report on the swollen NYSE margins (not typical of bear market bottoms). Volume on the NYSE is still much too high to suggest a major bear bottom. Dividend yields on common stocks are not in the 7% to 10% zone associated with a major bottom area. The low-priced stock indexes have not really caved in. Pessimism (as I have said before) is not nearly black enough. The Dow Industrial stocks have not yet been liquidated in the fashion I would expect during the final windup of a bear market. Finally, the economic news is not of the wrenching, hopeless variety usually associated with a major primary bottom.

My studies indicate that this primary bear market is still in its second or (psychological) longest phase. This is the phase in which the market goes down as it reflects deterioration in the economic, political and social background for stocks. Logic would dictate that the second phase will end with new lows for the Averages, and this would mean an Industrial close under 631.16 (the 1970 low) and a Transport close under 116.69 (1970 low).

That may be a most depressing concept for my readers, but it is nevertheless what I expect. Lastly, the third phase of this bear market should take the Averages well below the 1970 lows on a final crushing slide to the bottom. The third phase will represent the real liquidation phase, the phase in which good stocks are sold because investors, institutions, corporations, pension funds, universities, will need to raise money. If this bear market does not end with such a period of forced liquidation, it will be the first primary bear market in history which has avoided the "final blood bath."

I have no doubt that many fund managers and corporate officers as well as individual investors believe we have already seen the blood bath. If you do, I am afraid you are going to be shocked at what is in store for us. I cannot seem to get over to most people the kind of pessimism which prevails at a final bear market bottom. But I believe a reading of the newspapers of 1932, 1942 or 1949 (look them up at your local public library) would prove most educational for the average investor. At the third phase bottom of this bear market I believe there is going to be gloom so thick it will stifle us. Bullishness will be greeted with downright anger (since people who are broke do not want to hear about "the new rise ahead"). The "answers," the hopes, the game plans, the brilliant new schemes will all have gone down the drain. But the worst will finally have been discounted, even though there will be very few who believe it.

For the near term, the picture is more confusing than heartening. On July 31 the D-J Industrial Average broke to a new four year low (below the July 11 low of 759.62, see page 1 chart), but Transports did not confirm, having failed to break their own July 11 low of 149.41. This could mean that the stage is being set for another rally — or it could be more deception on the part of the bear. Either way, the great primary trend is still down, which means that my subscribers will remain observers of the Wall Street scene — not in-and-out traders, guessing experts, jump-the-gun Johnnies or Merrill Lynch variety bulls (whatever happened to that herd-of-bulls ad?).

On the first day of August I started my market diary with a new low on the advance-decline ratio (the breadth of this market continues to be ghastly), a new low on the Primary Trend Index, a new low on the DJIA, the cumulative most-active stock index at its low. On August 2 a most bearish item appeared as the D-J 40-Bond Average crumbled to a new four-year low. "Will-Go" (Letter 604, page 3) has now broken down completely, giving another bearish forecast for the period ahead. I read Will-Go as saying a very unimpressive "summer rally" (at best) with a fresh (major) market break slated for early September. My own belief is that the most ominous action we could now see would be a "hanging on" or dull-rallying period over the next few weeks. That, I feel, would lay the groundwork for a third quarter collapse.

"A bear market is a good time to take a vacation," wrote Robert Rhea, the great Dow Theorist of the 1930's. If my job wasn't watching the market (secretly, of course, I love it) that's probably what I'd be doing now.

PRIMARY TREND: In his extraordinary book, "The Will to Happiness," Dr. A. Hutschnecker begins as follows: "A great truth sometimes appears so simple that it fails to make an impression and therefore takes a long time to be realized." That statement perfectly sums up the "secret" of the primary trend. I don't believe that there is another subject which I have labored so hard to get across to readers as the theory and meaning of the primary trend.

Regarding the general stock market, I have written repeatedly (since 1966) that we are in a primary bear market. What does that mean? It means that on February 9, 1966, the Averages discounted the very best that could be seen ahead for stocks and the

economy. On that day, for some mysterious reason, the great tide of the market turned from bull to bear, just as at some almost indeterminable second of each twenty-four hours, the day fades out and the seeds of night are born.

When the primary trend turns bearish, history tells us that the market will turn down and continue down (despite periodic and often spectacular corrections) until the worst that can be seen ahead is fully discounted in the price structure. This whole thesis may sound simple enough — but believe me it is not (at least for the man who is actually making decisions in the stock market). The reason it is not simple is that one must apply a theoreticians mind to a set of seemingly practical circumstances. "How can the tide be going out?" asks the broker or the stockholder or the housewife, "Isn't the Government watching unemployment, don't we have the SEC, the FDIC, the Fed, Social Security, and dozens of other safety measures?"

The sad answer to these arguments is that conditions are changing in a primary bear market. The plusses are turning into minuses, the safeguards are on their way to becoming liabilities, the fortresses of safety are springing leaks, the bear is tearing away at all the wonderful new mechanisms which are supposed to eradicate the possibility of suffering, pain and hardships from the financial scene forever.

Over and over since 1966 we heard the words of the optimists, "The worst must now be discounted. How can prices continue to go down? Stocks are basically sound and equities are still the only valid hedges against inflation." And now the latest, "At P/E ratios of 2 to 4, stocks are the cheapest they have been in decades."

All of which is fodder for the bear. He knows that the current quality of earnings is pathetic. He knows that stocks are going much lower. He knows that people are being deluded by comparison with recent history. He knows that stockholders are telling themselves what they want to hear. But most important, the bear knows that conditions are going to get much, much worse than anyone now foresees. Just as the great primary bull market of 1949-66 took prices higher than even the optimists thought possible, the bear of 1974 knows that before this great tidal downturn is over, there will be black pessimism, unbelievably low prices, bankruptcies, national emergencies, money crises, low, dragging volume, questions about the continuance of capitalism, and common stocks on an historic "bargain table" with no man seemingly in his right mind ready to take on the bargains.

The great tragedy of a true bear market (such as this one) is that it is here that the disastrous events feed on each other. A rumor starts, a bank fails, a speculator goes broke, bank depositors flee, a great corporation files for bankruptcy, capital spending is pulled back, consumers panic and the whole structure totters crazily like a man having a seizure. Make no mistake about it, what we're seeing here in 1974 is not another "quickie" recession of the 1958 or 1960 variety. We're seeing the storm clouds, the gathering forces of one of history's great bears. He's been held back and contained for many years, and he's not going to be satisfied until he's rampaged across the land with his full fury, until he can't fight anymore, until he's exhausted.

So much for the bear market. Happily for market students and investors (and those of us interested in surviving), there is a bull market going on simultaneously with the current world-wide bear market. That bull market is in real money (gold) and the shares which produce real money (gold stocks). The gold bull market has been going on since late-1969, and according to my calculations we have about completed the first and second (psychological) phases of the gold bull market and are now moving into the third or speculative phase.

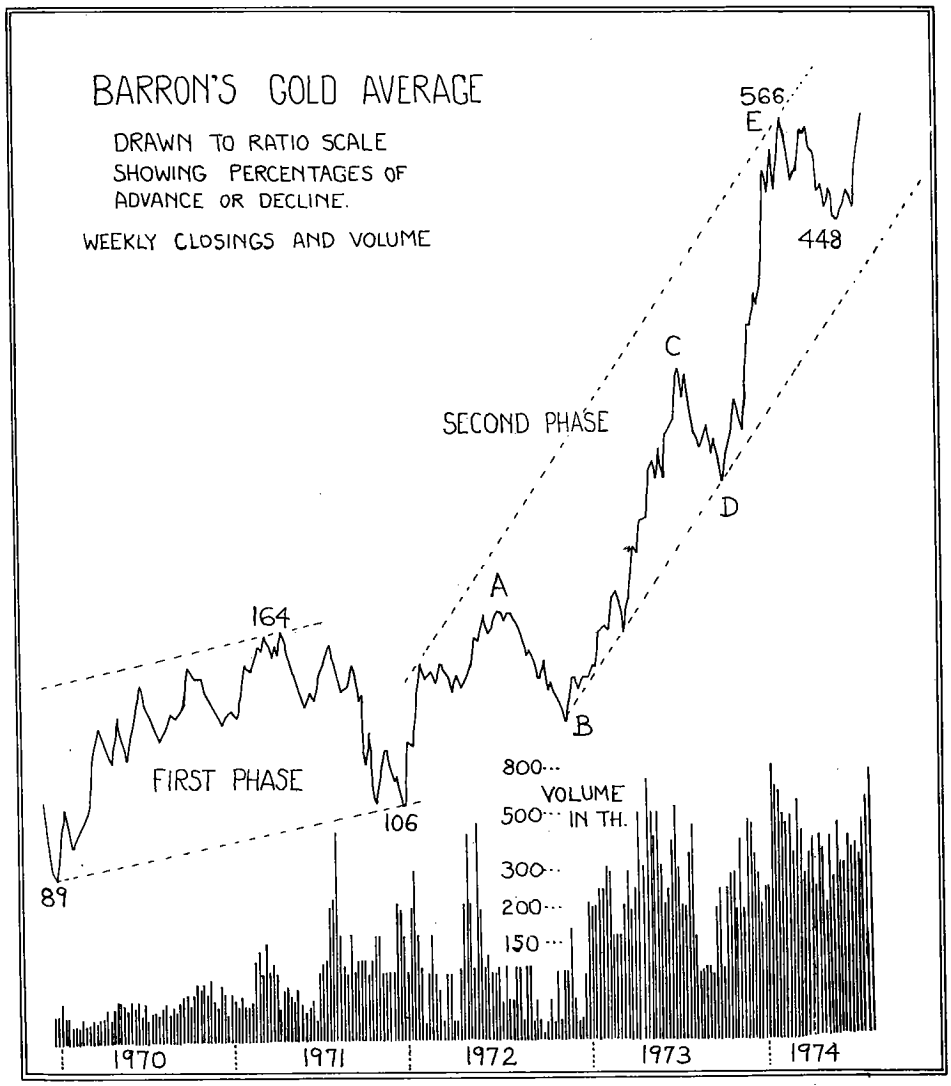
The third phase of a bull market is the one which sees widespread public participation and speculation. I don't know exactly how this third phase is going to work out; it could take six months or it could (more probably) take a year or a few years. The reason I give it the long end of the time span is because, as my colleague E. George Schaefer so often points out, "There's no fever like gold fever." Now the public has not caught the gold fever yet. They're only getting a little warm around the gills — but the real fever, not yet. And remember, it takes time for a fever to burn itself out.

A second reason why the third phase of the gold bull market will probably be extended is that world leaders are still afraid of gold. Gold means discipline for politicians and freedom for citizens. Politicians don't trust free markets, they don't trust free enterprise, they don't trust legal gold (which allows a man the freedom to turn in his fiat Government paper for real money). If you don't believe me, read this little clip from the Aug. 3 Business Week. But remember, the primary bull market in gold ultimately will have its way, it will express itself. And the longer it is contained, the higher it will go!

Gold: U. S. Treasury Secretary William Simon has won support from key European governments to neutralize any price rise after Americans are permitted to buy gold. The Europeans have agreed to let the International Monetary Fund sell enough gold to keep the price stable during the initial phase of buying by U. S. citizens. Though there is a bill in Congress to abolish the ban by Dec. 31, Simon is expected to pick his own time to move, probably on a price downswing in an effort to outwit the speculators.

Homestake made the weekly most-active-stock list three weeks running (July 19, 26, August 1). That's the first time any gold has entered the weekly most-active list since the gold bull market began. I believe it represents an early hint of the coming third phase gold boom. Volume for the four listed golds for the week ending July 26 jumped to 768,000, second highest volume in the past decade. That's another third phase preview. I'm including my chart (page 4) of Barron's Gold Average, and we note that on the week

ending July 26 the Average rose to an all-time high. That, of course, is a dramatic indication of the big third phase gold boom which is slowly building.



I have marked on this chart (which is scaled to ratio so that it shows percentages of advance or decline) the phases of the gold bull market. The first phase (1969-71) represented informed accumulation by knowledgable and bold investors. The second phase was characterized by heavier volume, sharp, scary corrections but continued investment-quality buying.

Note the 448 low on the Barron's Gold Average. This was the 1974 low which marked the bottom of the correction and the end of the second phase of the gold bull market. I might add that it was an indication of technical strength that the 448 low occurred well above the trend-line which connects the 1973 lows (through points B and D).

I believe the gold bull market is now moving into the very early stages of its third phase. In due time this should develop into a mighty tide, moving on until finally (with the strength of the ocean's tide) it inundates the face of the globe. I expect to see the gold bull market push up, correct, push up, correct, go up and up until it burst onto a paper-laden world with such force that even the most ardent gold bull will be astounded.

NOTES AND QUOTES: A few weeks ago we all heard big publicity about how the US was going to get $8 or $9 billion of recycled money from the Arabs. Then silence reigned. Now from the July 29 Money Manager comes the most illuminating information. We haven't got the loans yet. Anyone wonder why? Could it be that the Arabs want gold backing? Ah well, as readers of these reports know, I suggested that the Arabs might want just that. Even more ominous, Eliot Janeway in his latest Janeway Report notes that the Arabs have got the word that "Nixon is through, and that Kissinger could be." Consequently, he says, Washington's two big Arab deals are off: the first, bringing down oil prices (which Janeway feels could now go higher), and second, recycling billions of dollars.

* * * *

A subscriber has sent me an article by our new head of the Council of Economic Advisors, Alan Greenspan. The article (from the July, 1966) Objectivist is entitled "Gold and Freedom," and it shows that Mr. Greenspan not only understands gold but is an ardent pro-gold advocate. Couple that with Treasury Secretary Simon's wish to legalize gold and the picture starts to look interesting. Now for good measure, let's add the forecast made a few weeks ago (see clip) by the Treasury's Wolf to the effect that the US could well become the gold center of the world (what, and take the gold action away from Zurich and London? You better believe it).

Treasury Secretary William Simon's efforts to get the Saudi Arabian government to invest part of their oil surplus in non-marketable U.S. Government obligations may have hit a snag. No firm commitment on the Saudis' part came out of Mr. Simon's recent Middle East trip, but a team of U.S. experts has remained behind to nail down the deal.

The proceeds of the Saudi purchases are likely to be relent by the United States to other nations suffering from oil-related payments problems.

The Treasury is said to be willing to guarantee that the value of the Saudis' investment will not be whittled away by inflation and devaluation

However, there may be difficult for the United States to be able to get the same pledge from the nations to whom it lends the Arab monies. Thus, the United States runs the risk of being caught in the middle having to fully repay its debt to the oil producers while being only partly compensated by its creditors due to inflation or devaluation.

WASHINGTON — The United States could become the primary trading center for the world gold market when Americans are allowed to own gold again, a Treasury Department official predicted Thursday.

Treasury Secretary William Simon has said he hoped the ban could be lifted by the end of this year and both the Senate and the House of Representatives have passed bills which would see gold ownership a fact by January 1 at the latest.

Wolfe said he saw the United States becoming the world trading center for gold because for years it has been the world's largest gold consumer and because it has the most technically advanced markets for pricing and dealing in world commodities.

He said the lack of historical precedent of Americans desiring to hold gold made him believe there would be no great demand for the metal once private citizens are allowed to own it.

All of which fits in with my long-held prediction that the US will do a total flip-flop on gold, suddenly decide that gold is wonderful, rather than "barbaric," and finally the US will become ardently pro-gold. At any rate, this may give some hints as to why Homestake has been blasting into all-time high territory. After all, HM's management undoubtedly knows more about producing gold than anyone else in the US, HM has lots of cash and reserves, and with the US Government about to embrace the yellow metal, well.... And what happens when the public and the funds comprehend the meaning of "the big switch?"

* * * *

All the major currencies are charted here daily, and it is evident that over the past few months the dollar has been strong (against the other currencies). The weakest currency is the yen, which has been hitting new lows daily. I have the feeling of big trouble coming up in Japan. Last week Datsun announced a one-third cutback in its auto shipments to the US. On July 2 the Japanese stock market took its biggest dive of the year. Japan is a place to watch.

* * * *

Fed. Reserve Chairman Arthur Burns told the House Banking & Currency Committee (July 30) that "loose fiscal policies" were mainly responsible for current inflation. Then he said that he would like to balance the budget this year or preferably have a budget surplus. Ah yes, but here is the Burns statement in that speech that interested me the most: "In the future, as in the past, we will surely not stand aloof and permit crisis to develop out of devotion to this or that preconceived growth rate of the money supply." Which I translate to mean that if business starts to sag and unemployment starts to rise, the Fed will open the flood-gates again. I believe they call it monetary inflation!

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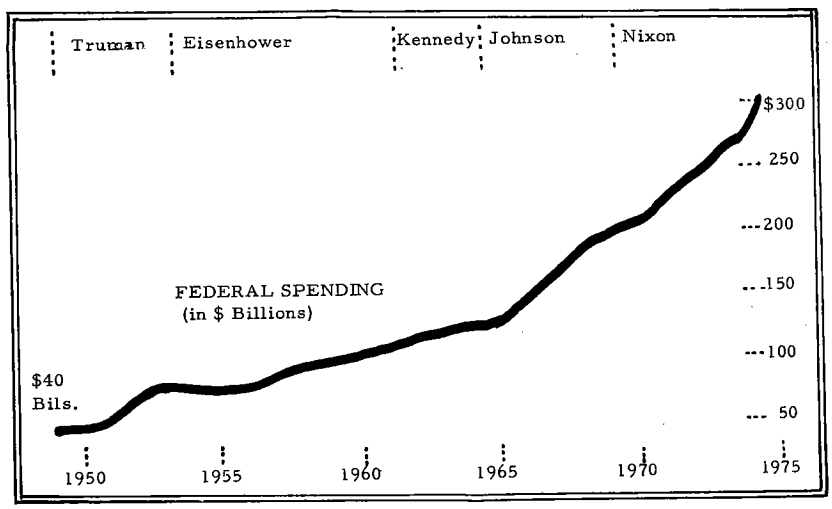
As veteran subscribers know, I have always held that a good chart is worth at least a carload of political bunk. I have drawn up this little chart showing how our Federal expenditures are going. Currently, the Administration is saying that they are going to try to lop off about $5 billion from the 1975 budget. I look at this chart and ask myself, "Five billion, what's that going to do? It's like eating the full lasagna dinner at Mama Leone's in NYC and cutting out the celery."



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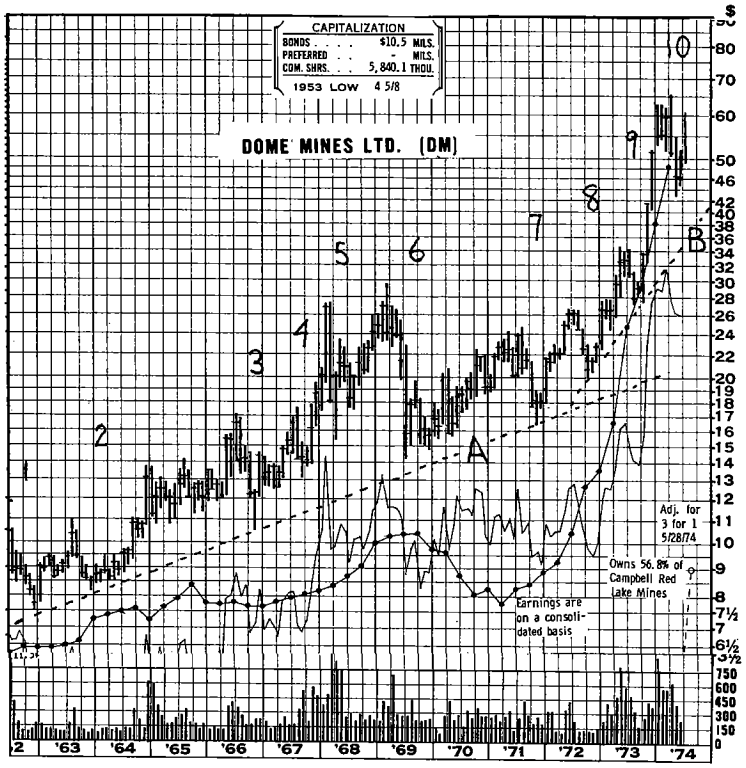
The banking and finance sector of the nation is in an increasingly serious predicament as the various members take on all comers for money. The new Treasury 9% notes (in $1,000 denominations) can only be described as fantastic, and this following Citicorps "floating notes" (everyone is now chasing the little guy's $1,000 savings accounts). What we are seeing here is history's greatest battle for liquidity, and the battle is just warming up.

The Savings & Loans are in a particularly interesting situation at this time. Their average yield on their invested portfolios is about 7.3%. Their average cost for new money is around 6.3% (passbooks, etc.), but that isn't going to last. It costs the S & L's 3/4% to 1% to do business. That means that they're now near working for nothing. Big chunks of new money via C/D's costs the S & L's 11% or more. Figure it out; they're being squeezed and squeezed hard. And now that the banks (with "floating notes") and the US Government (with $1,000 notes yielding 9%) are taking them on, they could lose heavily on deposits. And that's the way bear markets work.

GOLDS: One concept worth mentioning is the fact that there are now about 30 million stockholders in the US, most of them showing losses on their holdings. As this bear market progresses and as the attraction of gold stocks as survival vehicles becomes apparent, I believe there is going to be a steady movement on the part of stockholders towards gold participation in their portfolios. In fact, the situation could be so grim that ownership of gold and gold shares could be tantamount to staying solvent.

In view of this, it is worth noting that the supply of gold shares is very limited. Technical Stock Reports (Palisades Pk, NJ 07650) keeps interesting tabulations on many stocks, and one of these they term the "floating supply." The floating supply is the difference between a stock's total capitalization and the number of shares closely held. In other words, the floating supply is the supply generally available on the market. TSR lists the floating supply for the gold shares as follows: ASA 4.8 million, Campbell 3.1 million, Dome 4.9 million, Homestake 5.2 million, Rosario 4.1 million, Giant Yellow (Amex) 3.4 million. This gives us a total of 25.5 million shares of listed golds. By comparison, GM's floating supply is 273 million, General Electric is 165 million, Xerox is 68 million. As a rule, the smaller the floating supply, the more volatile the potential movements in a stock or group of stocks. Thought for the week: there are 30 million US stockholders and 25 million shares (floating supply) of listed golds. Now if each investor wanted to buy one share...

I guess you can call this current Letter 605 a "special report" on the concept of the primary trend. I would like readers to study the monthly chart of Dome Mines as shown. I consider that Dome has been in an overall rising trend during the entire period covered by this chart. Yet during these 13 years there have been 10 good corrections in Dome as labeled on the chart (numbers 1 through 10). Nevertheless, the rising trendline marked A has contained all the reactions since the 1960's.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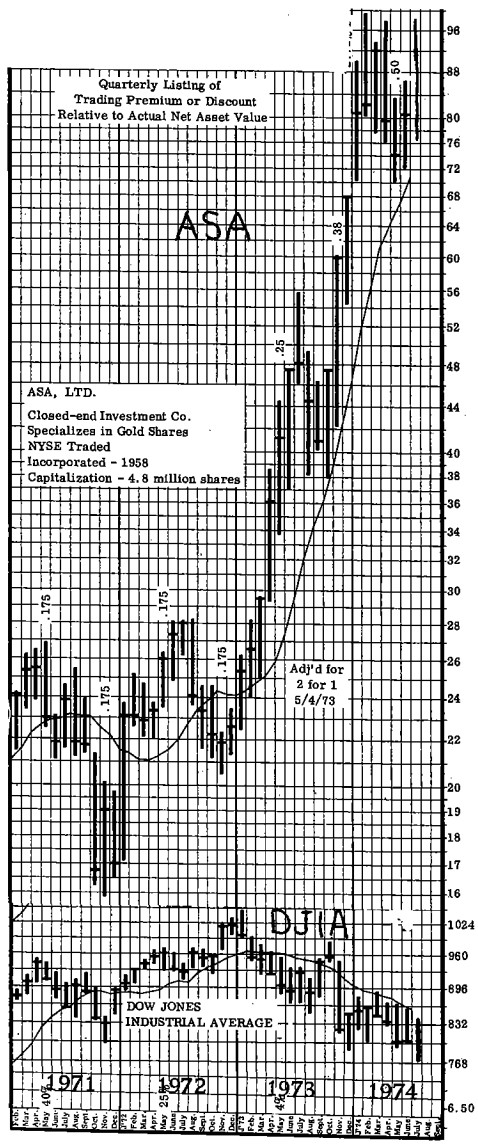
DOME MINES LTD. (DM)
Adj. for 3 for 1 5/28/74
Owns 56.8% of Campbell Red Lake Mines
Earnings are on a consolidated basis
'63 '64 '65 '66 '67 '68 '69 '70 '71 '72 '73 '74

Look at each of these reactions and ask yourself whether you would have been willing to sit through them. Give special attention to the reactions following the 1969 crunch, because it is after 1969 that I consider that the real gold bull market began. You might say to yourself, "Oh, it would have been easy to sit with Dome as Russell has suggested. After all, it has held beautifully above the trendline. No sweat." But that's an observation in retrospect. And remember, each reaction had its own scary "news event," just as today we have the story of Canadian taxes plus continued international propaganda against gold. And gold will have more to contend with in the period ahead.

Note that following 1969 I have drawn steeper trendline B. This trendline has contained all reactions in Dome from 1969 to the present. Furthermore, I believe it will contain all future reactions until Dome blows its top and finishes off the current bull market in golds. So again, I will say to readers, look at the big picture, stay with the primary trend of golds. Read the anti-gold news stories and the anti-gold propaganda and the anti-gold advisory service bunk if you must but remember this — the primary trend of gold is stronger than all the noise coming out of all the capitals of the world, it is more powerful than the US, the Arabs, the Russians and the London Economist (I couldn't resist that last one) all taken together. After all, they have been fighting gold for years, and at present my chart says that gold is still winning — and it will win. It always has, from the time of the ancient Egyptians to today. (Chart of Dome courtesy Security Research, 208 Newbury St., Boston, MA 02116).



Here is a ratio chart montage showing the percentage movements of ASA and the Dow Industrials over the past four years. If you have any doubts as to where the primary bull market and where the primary bear market is, this chart should go a long way towards clearing up the mystery. Again I will stress this theme: I expect the gold market to "shoot its wad" before it's exhausted, and I expect the Dow to be "wiped out" on the downside before the third phase of the bear market in common stocks is over. All that will take time, however, and our job is to keep our eyes on the big picture. (Charts from Growth Fund Guide, PO Box 2109, San Clemente, CA 92672).

The average investor goes broke because he cannot see the forest for the trees. I consider one of my main tasks to be clearing away the trees. It's not an easy job, and it's not an easy path for readers to follow. But it's a hell of a lot easier than paddling upstream or running up the down-escalator.

LATE NOTES: This market is obviously "oversold," and here with Transports having failed to confirm on the downside (below the July low of 149.41) and with volume drying up, Wall Street is making another attempt to get a rally going. As I said previously, I would consider a weak rally (which I feel is the best we can get) or a "holding action" to be bearish. I feel that a big downside move is building up for the September-October period, even if the market rallies here. The economy is moving towards recession now, and the big question is — at what point will the Fed panic and "open wide the money gates." Stocks to buy here... Homestake, ASA, West Driefontein, Dome.